Supreme Court of the United States

OCTOBER TERM, 1945.

NEVILLE COKE & CHEMICAL COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

JOHN P. OHL,
Counsel for Petitioner.

Pandick Press, Inc., 22 Thames St., New York 6, N. Y., U. S. A.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner, Neville Coke & Chemical Company, by its counsel, prays that a writ of certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Third Circuit entered in the above entitled cause on March 22, 1945.

Opinions Below.

This cause originated by the filing of a petition in the United States Board of Tax Appeals (now the Tax Court of the United States) to review the determination of the Commissioner of Internal Revenue that there were deficiencies in petitioner's income and excess profits taxes and a

deficiency and penalty in personal holding company surtax, all for the calendar year 1936. The opinion of the Tax Court redetermining the deficiency was entered on January 25, 1944 and is reported in 3 T. C. 113 (Record, page 3a).

The petitioner petitioned the United States Circuit Court of Appeals for the Third Circuit to review the decision of the Tax Court. The opinion of the Circuit Court of Appeals is reported in 148 F. (2d) 599 (R. 174).

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on March 22, 1945 (R. 181). The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, as amended, 43 Stat. 938 (28 U. S. C. § 347).

Question Presented.

The question presented is whether a taxable gain was recognized when petitioner relinquished certain promissory notes of a debtor corporation in exchange for new debentures and common stock of the reorganized corporation, in pursuance of a plan of recapitalization approved by the court in reorganization proceedings under Section 77B of the National Bankruptcy Act, as amended.

Statute and Regulations Involved.

The relevant parts of the Revenue Act of 1936 and Regulations 94 are set forth in Appendix A. Pertinent portions of the Revenue Act of 1943 and Regulations 111 are set forth in Appendix B.

Statement of Facts.

Petitioner in 1935 was a creditor and stockholder of Davison Coke & Iron Company.* Petitioner held the following securities of Davison:

Type of Security	Face Value or Number of Shares
First Mortgage Bonds	$ 500,000
Three, Four and Five Year Notes	1,129,000
Prior Preferred Stock	15,694
Preferred Stock	2,500
Common Stock	14,701

Petitioner also held accounts receivable from the debtor corporation (R. 5a, 19a).

The three, four and five year notes had been issued by the debtor in 1932 to its six principal creditors, in pursuance of a voluntary reorganization out of court (R. 4a, 15a, 86a, 89a, 91a-93a, 98a). The notes were dated April 1, 1932, and the four and five year notes bore interest after three years at six percent, payable semi-annually (R. 92a). Each note gave the holder the option to convert up to 50% of the face amount thereof into prior preferred stock of the debtor at its stated value of $50 per share, such option to be exercised on or before three years from the date of the note (R. 90a-91a, 92a). The principal amount of the three, four and five year notes issued by the debtor aggregated $1,910,700, which represented a substantial amount of the total investment in the enterprise (R. 6a, Ex. A). Petitioner acquired the debtor's notes

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* Now the Pittsburgh Coke & Chemical Company.

held by it upon petitioner's organization in 1933 (R. 4a-5a).

In 1935 the debtor defaulted in the payment of the principal amount of the three year notes and filed a petition in bankruptcy under Section 77B to effect a plan of reorganization (R. 6a). The plan of reorganization approved by the court effected a readjustment of the debtor's capital structure (R. 6a). It is not disputed that the reorganization of the debtor carried out pursuant to said plan constituted a recapitalization and therefore a "reorganization" as defined in Section 112(g)(1) of the Revenue Act of 1936.

Pursuant to the court-approved plan of reorganization, petitioner in 1936 relinquished the following stock, securities and other obligations of the debtor and received in exchange therefor the following:

Items Surrendered	Face Value or No. of Shares	Items Received: Debentures (par value)	Items Received: Stock (No. of Shares)	Items Received: Notes and Cash
First Mortgage Bonds	$ 400,000.00	$ 400,000.00	10,000	$ .....
Three, Four and Five Year Notes	1,129,000.00	1,129,000.00	22,580	.....
Accounts Receivable (Preferred)	67,884.60	.....	1,273	67,946.87
Accounts Receivable (not Preferred)	86,550.00	86,000.00	1,720	576.32
Prior Preferred Stock	15,694 shs.	.....	109,465	6.50
Preferred Stock	2,500 "	.....	7,500	.....
Common Stock	14,701 "	.....	1,470	1.00
		$1,615,000.00	154,008	$68,530.69

There is no dispute as to the tax consequences of the exchanges of the bonds, stock and accounts receivable for new debentures, common stock and notes. The only exchange in question is the relinquishment of the notes in consideration of the acquisition of new debentures and common stock of the reorganized debtor. In determining the deficiencies involved in this proceeding respondent held that the gain realized by petitioner upon that exchange was recognized, since the notes did not constitute "securities" within the meaning of Section 112(b)(3) of the Revenue Act of 1936.

Petitioner, on the other hand, claims that the notes relinquished in the exchange were "securities" within the meaning of Section 112(b)(3) and that therefore no gain was recognized upon such exchange.

Reasons for Granting the Writ.

I. The decision of the Circuit Court of Appeals is in conflict with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Burnham* v. *Commissioner*, 86 F. (2d) 776 (1936), cert. denied, 300 U. S. 683 (1937).

The decision below holds that three, four and five year notes relinquished by petitioner in the 77B reorganization of the debtor in exchange for new debentures and common stock of the reorganized company, were not "securities" under Section 112(b)(3) of the Revenue Act of 1936. On the other hand, in the *Burnham* case, *supra*, the Seventh Circuit held that an unsecured corporate note, exchanged two years after its issuance, was a "security" within the meaning of identical provisions of Section 112(b)(3) of the Revenue Act of 1928.

There is a flat conflict between these two cases. Each case involves an exchange in pursuance of a recapitaliza-

tion, constituting a "reorganization" under identical provisions of the Revenue Acts. Furthermore, the question decided in each case is identical.

II. The decision of the Circuit Court of Appeals misapplies and is an unwarranted extension of the scope of the decisions of this Court in *Pinellas Ice & Cold Storage Company* v. *Commissioner*, 287 U. S. 462 (1933) and *LeTulle* v. *Scofield*, 308 U. S. 415 (1940).

In *Pinellas Ice & Cold Storage Company* v. *Commissioner, supra*, this Court first enunciated the doctrine of continuity of interest and applied it to distinguish a taxable sale from a tax-free reorganization. In *LeTulle* v. *Scofield, supra*, this Court, elaborating upon the decision in the *Pinellas* case, added that the doctrine of continuity of interest is not satisfied unless the transferor retains a "proprietary" interest in the transferee. The Circuit Court of Appeals has construed these decisions to require the transferor also to have a "proprietary" interest in the enterprise *prior* to the exchange. Thus, the decision below by this process of reasoning eliminates a creditor's interest from the category of "securities" as used in Section 112(b)(3) of the Revenue Act of 1936.

Petitioner urges that the lower court's decision is a clear misapplication of the *Pinellas* and *LeTulle* cases and should be reviewed by this Court.

III. The decision of the Circuit Court of Appeals, holding that corporate notes are not "securities" under the non-recognition provisions of the Revenue Acts raises a novel and important question of construction of Federal law which should be settled by this Court.

The term "securities" as used in Section 112(b)(3) of the Revenue Act of 1936 was not defined in the Act or the Regulations thereunder, nor in the corresponding provisions

of any prior or subsequent Revenue Act or Regulations. In the absence of an express definition, the language of a statute is to be read in its natural and common meaning. The natural and common meaning of the term "securities" indisputably includes corporate notes and Congress itself has on numerous occasions, in Revenue Acts prior and subsequent to the Revenue Act of 1936, expressly so defined it. Whenever it was intended that the term should have a special or restricted meaning, Congress has provided an express definition for the guidance of the taxpayer and the courts.

IV. An authoritative determination by this Court of the question whether a corporate note may be a "security" for the purposes of the non-recognition provisions of the Revenue Acts is important to a proper administration of the revenue laws.

At the present time the Government is arguing both sides of the question. For example, see *Hoagland Corporation* v. *Commissioner*, 121 F. (2d) 962 (C. C. A. 2d, 1941), in which the Government contended and the Second Circuit agreed, as an alternative ground of decision, that a demand promissory note was a "security" within the meaning of the non-recognition provisions of the Revenue Act of 1934, which are identical with the non-recognition provisions of the Revenue Act of 1936. Such uncertainty not only greatly increases the expense of administering the tax laws, but imposes a similar additional burden upon the many taxpayers who have relinquished or received corporate notes in connection with exchanges, recapitalizations and reorganizations.

The question whether a corporate note is a "security" is one of continuing importance, for the Revenue Acts prior and subsequent to that of 1936 and the Internal

Revenue Code contain provisions identical with those involved in the instant case. The difficulty and uncertainty of this question were adverted to in *LeTulle* v. *Scofield, supra,* at page 420.

It is submitted that a review by this Court of the instant case would eliminate, both for the Treasury Department and taxpayers, the doubt, uncertainty and burden of litigation which is the result of existing law and particularly of the decision below.

Conclusion.

WHEREFORE, for the reasons stated above and discussed more fully in the annexed brief, your petitioner prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Third Circuit, to the end that the above cause may be certified to and reviewed and determined by this Court as provided in Section 240 of the Judicial Code, as amended, 43 Stat. 938 (28 U. S. C. § 347), and that the judgment of the said Circuit Court of Appeals in the above entitled cause may be reviewed by this Court, and your petitioner prays for such other and further relief as this Court may deem just and proper.

Respectfully submitted,

JOHN P. OHL,
Counsel for Petitioner,
63 Wall Street,
New York 5, N. Y.

Dated: New York, N. Y.,
June 21, 1945.